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No. 89-1448

In the Supreme Court of the United States

OCTOBER TERM, 1989

VIRGINIA BANKSHARES, INC., ET AL., PETITIONERS,

v.

DORIS I. SANDBERG, ET AL., RESPONDENTS.

FIRST AMERICAN BANKSHARES, INC., ET AL., PETITIONERS,

v.

PAUL H. WEINSTEIN, ET AL., RESPONDENTS.

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF FOR THE PETITIONERS

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QUESTIONS PRESENTED

1. Whether subjective opinions and characterizations used in a proxy statement may violate Section 14(a) of the Securities Exchange Act of 1934 when the proxy statement discloses the underlying material facts needed to enable shareholders to decide for themselves whether to accept the opinions and characterizations or to reject them on grounds of potential conflict of interest or ulterior motivation.

2. Whether a plaintiff may invoke an implied cause of action for damages under Section 14(a) of the Securities Exchange Act of 1934 when the allegedly misleading proxy statement could not possibly have affected the outcome of the proxy vote and the plaintiff has not demonstrated causation in any other way.

PARTIES TO THE PROCEEDING AND RULE 29.1 STATEMENT

In addition to the parties named in the caption, the following persons were defendants in the district court and appellants in the court of appeals and are petitioners in this Court:

Emanuel A. Baker, Jr.
Harriet F. Bradley
Thomas B. Chamberlin
Sidney O. Dewberry
Eric W. Erdossy
Charles T. Lindsay, Jr.
Linda H. Michael
E. Guy Ridgely
Charles H. Smith, Jr.
Henry A. Thomas
Jack W. Beddow
Joel T. Broyhill
Thomas P. Chisman
Milton L. Drewer, Jr.
George W. Johnson
Donald R. Maxfield
Milton V. Peterson
Glenn W. Saunders
Verlin W. Smith
Stephen G. Yeonas

In addition to the parties named in the caption, the following persons and corporations were plaintiffs in the district court and appellees in the court of appeals and are respondents in this Court:

Roslyn L. Weinstein
Richard Weinstein
Leonard Weinstein
Gary Plushnick
William B. Docksер
Philip Gross
John P. Kyle
Robert I. Schattner
Dante E. Guazzo
Helene D. Engel
Barbara L. Eller
W. G. Dolvin
Kathryn M. Everhart
Omer L. Hirst
Dorothy Fowler Cooper
Edward S. Loveless
Elizabeth K. Puzak
Said Haddad
Joseph B. Latshaw, Jr.
Claude E. Keener, Sr.
Luther A. Gilliam
William L. Mason
Jane M. Dinunzio
Stephen Hartwell
Ethel J. Reid
Patricia Hooker Bonnes
Kathryn Hooker Spradlin
Eugene Hooker Walter
Rebecca Weybright
Anne Carol Weybright
Robert and Bernice Walter
Stephen W. Hartwell, II
Edwin Lynch
Clarice Brault
Jay Weinstein
Helen Weinstein
Evelyn Bushwick
Carol Plushnick
Laura Lee Cookson
Nancy Gross
Kay Kyle
Helen Mackey Gray
General Harry J. Engel
Joseph M. Eller
Henry P. Deyerle
Cynthia B. Dolvin
Norman T. Henry
Katherine Ann Johnson

Thelma H. Loehler
Michael A. Puzak
Benjamin Weiner
Harold E. Shomo
P. S. Webb Co.
Claude E. Keener, Jr.
Foundation for Middle East Peace
Rudolph A. Dinunzio
Anna C. Hooker
Dorothy V. Tobin
Suzanne Hooker Evans
Joseph Edmund Hooker
Mary Helen Walter
Steven Daniel Weybright
David Hooker Weybright
Nokesville Church of the Brethren
Elizabeth H. Nixon
Anthony Colasanto
Helen M. Lynch

Petitioner First American Bankshares, Inc. is the parent company of petitioner Virginia Bankshares, Inc. Neither company has subsidiaries other than wholly-owned subsidiaries.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
PARTIES TO THE PROCEEDING AND RULE 29.1 STATEMENT	ii
TABLE OF AUTHORITIES	vii
OPINIONS BELOW	1
JURISDICTION	1
STATEMENT	1
A. The Merger Proposal	2
B. The Bank's Approval of the Merger	5
C. The Proxy Solicitation	8
D. The State Court Litigation	10
E. The Federal Court Litigation	11
F. The Decision of the Court of Appeals	13
SUMMARY OF ARGUMENT	15
ARGUMENT	19
I. PERSONS WHO SOLICIT PROXIES MAY NOT BE HELD LIABLE UNDER FEDERAL PROXY LAW FOR EXPRESSION OF SUBJECTIVE OPINIONS OR USE OF INDEFINITE CHARACTERIZATIONS WHERE THE UNDERLYING MATERIAL FACTS ARE FAIRLY DISCLOSED	19
A. Opinions And Characterizations That On Their Face Are Indefinite And Unverifiable Expressions Cannot Constitute Misstatements Of Material Fact Under Section 14(a)	20

TABLE OF CONTENTS—Continued

Page

B. Even If Some Characterizations Or Opinions Could Support Liability Under Section 14(a), The Expressions In This Case Cannot Because They Were Accompanied By Objective Facts That Enabled Shareholders To Make Their Own Evaluations 29

II. A PLAINTIFF INVOKING AN IMPLIED CAUSE OF ACTION FOR DAMAGES UNDER SECTION 14(a) OF THE SECURITIES EXCHANGE ACT MUST DEMONSTRATE THAT THE ALLEGED PROXY VIOLATION CAUSED THE INJURY THE PLAINTIFF SEEKS TO REDRESS 37

A. Respondents Cannot Establish Causation Because The Outcome Of The Shareholder Vote Could Not Have Been Affected By Any Defect In The Proxy Statement 39

B. Even If Non-Voting Injuries Are Deemed Cognizable Under Section 14(a), Respondents Have Not Proved That The Proxy Statement Caused Them Any Harm 45

CONCLUSION 50

STATUTORY APPENDIX SA-1

TABLE OF AUTHORITIES

CASES:

Page

Alabama Farm Bureau Mutual Casualty Co. v. *American Fidelity Life Ins. Co.*, 606 F.2d 602 (5th Cir. 1979), cert. denied, 449 U.S. 820 (1980) 32, 47

Basic Inc. v. *Levinson*, 485 U.S. 224 (1988) 38, 39

Bastian v. *Petren Resources Corp.*, 892 F.2d 680 (7th Cir.), cert. denied, 58 U.S.L.W. 3769 (1990) 44

Biesenbach v. *Guenther*, 588 F.2d 400 (3d Cir. 1978) 32

Blue Chip Stamps v. *Manor Drug Stores*, 421 U.S. 723 (1975) 23, 38, 45

Board of Trustees v. *Fox*, 109 S. Ct. 3028 (1989) .. 28

Brunswick Corp. v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977) 42

Bulgo v. *Munoz*, 853 F.2d 710 (9th Cir. 1988) 21

Business Roundtable v. *SEC*, No. 88-1651 (D.C. Cir. June 12, 1990) 27

Data Probe Acquisition Corp. v. *Datatab, Inc.*, 722 F.2d 1 (2d Cir. 1983), cert. denied, 465 U.S. 1052 (1984) 23

Dirks v. *SEC*, 463 U.S. 646 (1983) 23, 38

Ernst & Ernst v. *Hochfelder*, 425 U.S. 185 (1976) .. 21

Field v. *Trump*, 850 F.2d 938 (2d Cir. 1988), cert. denied, 109 S. Ct. 1122 (1989) 32

Franchard Corp., Securities Act Release No. 4710, [1964-1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,113 (July 31, 1964) 26

Goldberg v. *Meridor*, 567 F.2d 209 (2d Cir. 1977), cert. denied, 434 U.S. 1069 (1978) 35

Golub v. *PPD Corp.*, 576 F.2d 759 (8th Cir. 1978) .. 32, 35

Gomez v. *United States*, 109 S. Ct. 2237 (1989) 27

Healey v. *Catalyst Recovery of Pennsylvania, Inc.*, 616 F.2d 641 (3d Cir. 1980) 46

J.I. Case Co. v. *Borak*, 377 U.S. 426 (1964) 39, 42

Kademian v. *Ladish Co.*, 792 F.2d 614 (7th Cir. 1986) 31

TABLE OF AUTHORITIES—Continued

	Page
Kas v. *Financial General Bankshares, Inc.*, 796 F.2d 508 (D.C. Cir. 1986)	31, 32, 35
Kidwell ex rel. Penfold v. *Meikle*, 597 F.2d 1273 (9th Cir. 1979)	46
Kohn v. *American Metal Climax, Inc.*, 458 F.2d 255 (3d Cir.), cert. denied, 409 U.S. 874 (1972)	35
Lessler v. *Little*, 857 F.2d 866 (1st Cir. 1988), cert. denied, 109 S. Ct. 1130 (1989)	35
Lowe v. *SEC*, 472 U.S. 181 (1985)	28, 29
Madison Consultants v. *FDIC*, 710 F.2d 57 (2d Cir. 1983)	46, 47
Milkovich v. *Lorain Journal Co.*, No. 89-645 (June 21, 1990)	28
Mills v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970)	14, 37, 39, 40, 46
Mills v. *Esmark, Inc.*, 544 F. Supp. 1275 (N.D. Ill. 1982)	35
Parklane Hosiery Co. v. *Shore*, 439 U.S. 322 (1979)	37
Pinter v. *Dahl*, 486 U.S. 622 (1988)	23
Piper v. *Chris-Craft Industries*, 430 U.S. 1 (1977)	25, 41, 42, 45
Posadas de Puerto Rico Associates v. *Tourism Co.*, 478 U.S. 328 (1986)	28
Presidio Enterprises v. *Warner Bros.*, 784 F.2d 674 (5th Cir. 1986)	20
Radol v. *Thomas*, 534 F. Supp. 1302 (S.D. Ohio 1982), later proceeding 556 F. Supp. 586 (S.D. Ohio 1983), aff'd on other grounds, 772 F.2d 244 (6th Cir. 1985), cert. denied, 477 U.S. 903 (1986)	30, 35
Rondeau v. *Mosinee Paper Corp.*, 422 U.S. 49 (1975)	44, 45
Santa Fe Industries v. *Green*, 430 U.S. 462 (1977)	*passim*
Schlick v. *Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974), cert. denied, 421 U.S. 976 (1975)	41, 42, 43, 45, 48, 50
SEC v. *Medical Committee for Human Rights*, 404 U.S. 403 (1972)	28

TABLE OF AUTHORITIES—Continued

	Page
SEC v. *National Securities, Inc.*, 393 U.S. 453 (1969)	39
SEC v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969)	21
Shearson/American Express Inc. v. *McMahon*, 482 U.S. 220 (1987)	42
Sundstrand Corp. v. *Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir.), cert. denied, 434 U.S. 875 (1977)	42
Swanson v. *American Consumers Industries*, 475 F.2d 516 (7th Cir. 1973)	46
Touche Ross & Co. v. *Redington*, 442 U.S. 560 (1979)	42
TSC Industries v. *Northway, Inc.*, 426 U.S. 438 (1976)	23, 35, 40, 46
Virginia Pharmacy Board v. *Virginia Consumer Council*, 425 U.S. 748 (1976)	28
Ward v. *Succession of Freeman*, 854 F.2d 780 (5th Cir. 1988), cert. denied, 109 S. Ct. 2064 (1989)	21, 32
Wilko v. *Swan*, 346 U.S. 427 (1953)	42

STATUTES AND REGULATIONS:

Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.*	
Section 10(b), 15 U.S.C. § 78j(b)	39, 43
Section 12(i), 15 U.S.C. § 78*l*(i)	12
Section 14(a), 15 U.S.C. § 78n(a)	*passim*
Section 14(e), 15 U.S.C. § 78n(e)	25
Section 15(b)(4), 15 U.S.C. § 78*o*(b)(4)	44
Section 21(d), 15 U.S.C. § 78u(d)	44
Section 28(a), 15 U.S.C. § 78bb(a)	39
Section 32(a), 15 U.S.C. § 78ff(a)	44
12 C.F.R. § 335.206	12, 15, 20
12 C.F.R. § 335.212	21
17 C.F.R. § 240.14a-3	21
17 C.F.R. § 240.14a-9	20
Va. Code Ann. § 13.1-614	11

TABLE OF AUTHORITIES—Continued

	Page
Va. Code Ann. § 13.1-692.1	12, 27
Va. Code Ann. § 13.1-718E	9
LEGISLATIVE HISTORY:	
H.R. Rep. No. 1383, 73d Cong., 2d Sess. (1934)	40
S. Rep. No. 792, 73d Cong., 2d Sess. (1934)	40
MISCELLANEOUS:	
E. Aranow & H. Einhorn, *Proxy Contests for Corporate Control* (1968)	25
BeVier, *A Comment on Professor Wolfson's 'The First Amendment and the SEC,'* 20 Conn. L. Rev. 325 (1988)	29
Easterbrook & Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 Va. L. Rev. 669 (1984)	24
Easterbrook & Fischel, *Voting in Corporate Law*, 26 J.L. & Econ. 395 (1983)	25
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Herzel & Shepro, *Setting the Boundaries for Disclosure*, 16 Sec. Reg. L.J. 179 (1988)	24
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Jorden & Greif, *Federal Securities Fraud and State Law Fiduciary Duties—A Tour of the Circuits Reveals Continuing Confusion*, 19 Idaho L. Rev. 211 (1983)	43
H. Kripke, *The SEC and Corporate Disclosure* (1979)	25
L. Loss, *Fundamentals of Securities Regulation* (2d ed. 1988)	47
Oxford English Dictionary (2d ed. 1989)	34
Prosser and Keeton on Torts (5th ed. 1984)	44

TABLE OF AUTHORITIES—Continued

	Page
Ratner, *"Federal Corporation Law" Before and After Santa Fe Industries v. Green*, in *9th Annual Institute on Securities Regulation* (PLI 1978)	32
Webster's Third New International Dictionary (1971)	22, 34
Wolfson, *The First Amendment and the SEC*, 20 Conn. L. Rev. 265 (1988)	29

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BRIEF FOR THE PETITIONERS

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-26a) is reported at 891 F.2d 1112. The district court issued no written opinion in these cases.

JURISDICTION

The court of appeals entered its judgment on December 15, 1989. Pet. App. 4a. The petition for a writ of certiorari was filed on March 15, 1990, and was granted on April 23, 1990. The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

STATEMENT

This litigation grows out of a merger in May 1987 between First American Bank of Virginia ("the Bank")

and petitioner Virginia Bankshares, Inc. ("VBI"), which is a wholly-owned subsidiary of petitioner First American Bankshares, Inc. ("FABI"). Prior to the merger, VBI owned 85% of the Bank's stock. Approximately 2,000 minority shareholders owned the remaining 15% of the shares. As a result of the merger, the Bank became a wholly-owned subsidiary of its parent holding company, and minority shareholders received a cash payment of $42 for each of their shares—nearly $10 more than the highest price at which the shares had traded before the merger was announced.

A. The Merger Proposal.

For some time prior to the merger, Clark M. Clifford, the Chairman of the Board of FABI, had reviewed the possibility of a buyout of minority shares as a means to make the Bank more competitive. As he explained at trial, "[b]anking is a highly competitive business. Your competitors move quickly, and effectively; and you must be able to do so. If you have a minority interest in a bank, then you may not move as expeditiously as you might otherwise move." J.A. 380. Moreover, FABI owned majority interests in other banks that operated in Maryland and the District of Columbia. Consolidating some of these operations promised great efficiencies, but the presence of minority shareholders made consolidation difficult to achieve. J.A. 316 (testimony of Robert A. Altman). The need to achieve these efficiencies was not unique to FABI; "as a general proposition, it is rather unique in United States bank holding company operations for holding companies to have banking subsidiaries where there are minority shareholder interests." J.A. 315 (Altman testimony).[1]

During the second half of 1986, Mr. Clifford, who exercised decisionmaking authority on behalf of FABI (J.A. 382), began to consider whether a merger was feasible and, if so, how much should be offered for the

[1] See also J.A. 185 (testimony of Robert G. Stevens); J.A. 203-204 (testimony of Milton L. Drewer, Jr.).

Bank's minority shares. Clifford testified that he considered a number of factors in anticipating a price in the range of $38 to $40 per share. To begin with, at no time in its history had the Bank's stock ever sold for more than $32.50 per share. See J.A. 523. Although trading in the Bank's stock was not continuous, there had been a considerable number of trades in the three years prior to the merger (764 trades involving 343,108 shares), and all traders had access to detailed financial information disclosed in annual and quarterly financial reports and publicly available bank regulatory filings. Clifford therefore viewed historical and current market prices as a substantial indicator of value. See J.A. 330-334, 382-383. Furthermore, in the spring of 1986 the Bank had offered the minority shareholders the opportunity to purchase additional stock at $30 per share—$2 below the then-prevailing market price—yet fewer than half of the eligible shareholders exercised their rights to purchase the shares. J.A. 335-338, 522. This undersubscribed offering to shareholders served to confirm that the shares were not worth more than their current market price.

To assist it in reaching a decision regarding a fair price to offer for minority shares, FABI engaged the services of a prominent outside investment banking firm, Keefe, Bruyette & Woods, Inc. ("KBW").[2] KBW first examined a variety of factors relating to the financial strength of the Bank, including "the condition of the company"; whether it was "competitive in its market"; and whether its "financial ratios" were "acceptable within the framework of normal performance of a Virginia bank." J.A. 340 (testimony of Michael C. Connor).

[2] One of the directors of FABI explained that "we determined to contact Keefe, Bruyette because they were to our knowledge regarded as the premier banking house that specialized in banking properties." J.A. 304 (Altman testimony). Respondents' expert witness acknowledged that KBW is one of the top ten firms in the country in the field of publishing bank financial data and in "looking at and dealing with banking securities transactions." J.A. 143 (testimony of Daniel T. Krabill).

KBW then looked at the market for the stock and concluded that it "was a valid market. That is to say, that the price level of the stock prior to the offering being made, approximately $32 to $33 a share, did represent a price that took into account all available information that the public would need to establish a price level." J.A. 340. KBW recognized that the Bank's financial statements did not fully reflect some appreciation of the Bank's real estate holdings, but it concluded that these gains were offset by countervailing adjustments such as the Bank's lower loan loss reserves as compared to other banks. J.A. 355-356. KBW also considered the undersubscribed rights offering to be a significant indicator of value (J.A. 341):

> "If there had been a substantial interest in buying stock, it would have been reflected in a complete purchase and requects for more. The fact that it was not successfully subscribed was an indication that in fact the price levels then in the market reasonably reflected the combined view of the market on that price, that it was a fair market at that time, taking into account all information about the company that could be known."

Although KBW concluded that the current market price reflected the true value of the shares, it did not recommend that the merger be proposed at that price level. Rather, as KBW Vice President Michael Connor testified, KBW "looked at the fact that the company wanted to * * * make an offer that was unassailable from a reasonable standpoint. It was clearly a part of our charge from the company to arrive at a price that would be fair." J.A. 341. Hence, KBW suggested that FABI offer $42 per share, "a price that will show those minority shareholders that we are being fair, that we are offering them a substantial premium that isn't technically required but is being offered out of good faith." J.A. 347. KBW concluded that $42 would constitute "convincing evidence of the intent to be fair." J.A. 346. In accordance with this evaluation, KBW issued an opinion letter that, after detailing the terms of its employment

by FABI and the various factors that it took into account in assessing the shares' value, declared that "we are of the opinion that $42 per share represents a fair price for the shares of First American Bank of Virginia not currently owned by [FABI]." Pet. App. 75a-76a.

In light of his original expectation that FABI would offer between $38 and $40 per share, Clifford was surprised by KBW's recommendation that FABI offer $42 per share. But once KBW had suggested that price, he felt obliged to offer that amount. Clifford testified that "after Keefe, Bruyette had recommended the $42, then I could not go to $38 or $40 after they once made the recommendation. I couldn't go to the shareholders and say I was going to pay $40 but the adviser said $42. So that pretty well made up my decision for me." J.A. 384; see also J.A. 309 (Altman testimony) ("[h]aving sought that advice, we thought it was appropriate to accept it"); J.A. 185-186 (Stevens testimony); J.A. 203-204 (Drewer testimony).

To communicate FABI's decision to propose a merger at $42 per share, Clifford set up a meeting with Milton L. Drewer, Jr., Chief Executive Officer of the Bank. When Clifford told Drewer that FABI would offer $42 per share, Drewer was pleased with the offer and commented "that it was possibly some $10 more than the market at the time." J.A. 385 (Clifford testimony); see also J.A. 313 (Altman testimony) (Drewer "indicated that he thought the price was a very good price").

B. The Bank's Approval of the Merger.

On January 15, 1987, FABI's proposal was presented to the Bank's Board of Directors,[3] which instructed the

[3] The Board of Directors comprised 22 members, all of whom were themselves minority shareholders of the Bank's stock (owning 58,249 shares, or 8% of the minority shares). Only one of the directors, Jack Beddow, was affiliated with FABI or VBI, and 15 of the directors had over ten years of continuous service on the Board. Those directors assumed their positions before FABI's current management acquired any shares in the bank. See Pet. App. 47a-50a.

Board's Executive Committee to study the issue and make a recommendation to the Board. The Executive Committee, composed of 11 members of the Board, asked one of the other directors, Joel T. Broyhill, to join them in their deliberations because Broyhill (who owned 31,000 shares) was the largest of the minority shareholders on the Board, and the Committee "wanted to make sure that we have his opinion in with the * * * full discussion that we were having." J.A. 215 (Drewer testimony).

The Executive Committee called upon KBW to present its financial analysis and to respond to questions. J.A. 233 (Drewer testimony). Michael Connor and John Boyle, both Vice Presidents of KBW, made a presentation to the Executive Committee at which they explained their findings and conclusions. The Bank's in-house counsel and chief financial officer attended the meeting, and numerous questions were asked of the KBW representatives. J.A. 234. After the meeting, the Committee requested that KBW send additional information, including copies of charts and exhibits that KBW had used during its presentation. J.A. 219-221, 504-510.

The Executive Committee ultimately decided that FABI's $42 offer was fair and that it was unnecessary for the Bank to retain a second investment banking firm to appraise the value of the shares. J.A. 232-234. These views were transmitted to the Bank's full Board of Directors which, after deliberating on the merits of the offer, agreed with the Executive Committee that the offer was fair and that it was not necessary to hire another appraiser. In the course of the discussions of the Executive Committee and the full Board of Directors, various directors attributed different degrees of importance to factors such as the information presented by KBW,[4] the

[4] "I was quite impressed with the credentials of the firm [KBW], and then when they took the various things into consideration that they had in my mind based on some 30 years of experience of investments of various types, including managing stock portfolios where I am dealing back and forth with stocks, it seemed to me that they have covered it quite adequately. They have compensated for the fact that there was under-valued real estate by the fact that there were also reserves that were under. And I thought it [$42] was a very good figure. In fact I am very comfortable with the figure."

J.A. 371-372 (testimony of Charles Henry Smith, Jr.); see also J.A. 268 (testimony of Stephen G. Yeonas) ("Number one was the Keefe, Bruyette report. Number two, when they came to the meeting, I asked them questions. Other members of the Executive Committee asked them questions. I was satisfied with the answers that they gave").

members' own assessment of the value of the shares,[5] the undersubscribed rights offering at $30 per share,[6] the directors' business judgment that FABI was not likely to increase the offer,[7] and the Board's duty "to take special

[5] "Because I felt we had sufficient detailed information as to how they [KBW] arrived at the value, and we didn't need any further information, we knew the book value. We knew just as well as they did the appreciation of the value, the land. We knew what other bank stock was selling for. * * * I have been a stockholder of this bank for 20-some years and watched the market value of the stock. I had seen the dividends. I had seen the increase in value of the stock. And I felt that based on 22, 24 years that I had been a member of that board, and being an investor myself, I thought that was far more than generous."

J.A. 272-273 (testimony of Joel T. Broyhill); see also J.A. 266 (Yeonas testimony) ("I personally purchased stock in May of the year before at $32.50 a share. So I was making a substantial profit even on that individual purchase").

[6] J.A. 266 (Yeonas testimony) ("in our judgment the price was very fair at $42 a share; and we came to that conclusion for the following reasons: number one, was that the majority of the subscription rights at $30 a share were not purchased"); J.A. 288 (testimony of E. Guy Ridgely) ("A year prior to that time * * * [n]ew capital had to be raised and was offered to the existing stockholders at $30 a share. And here a year later the holding company is offering $42 a share"); J.A. 238 (Drewer testimony) ("it was getting tougher to get people to purchase the stock when we had offerings such as this").

[7] J.A. 218 (Drewer testimony) (the directors discussed whether they thought the "holding company would go any higher than $42"); J.A. 266 (Yeonas testimony) ("I was aware of the experience in Maryland. The holding company had made an offer in Maryland, which was rejected. Then the holding company continued to buy stock from the shareholders at a lower price, and I did not

consideration of the minority stockholders"[8]—particularly those minority shareholders who were anxious to sell their shares at this substantial premium price.[9]

The minutes of the Board's February 12, 1987 meeting declared that the Board unanimously resolved "that the Agreement and Plan of Merger is hereby approved and found to be in the best interests of First American Bank's shareholders and directed to be submitted for consideration by First American Bank's shareholders with the recommendation of the Board of Directors that it be approved by them." J.A. 458, 235.

C. The Proxy Solicitation.

In accordance with Virginia and federal law, a proxy statement, describing the proposed merger and the Board's recommendation, was prepared and sent to each stockholder in preparation for the annual stockholders' meeting. Because FABI owned 85% of the Bank's shares, it had far more than the two-thirds of the votes needed

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want to see our shareholders in that position"); J.A. 254 (testimony of Emanuel A. Baker, Jr.) ("it was clear in my mind that the holding company was making an offer of $42 cash, and the offer was firm"); J.A. 377 (testimony of George W. Johnson) ("I concluded that there was no room for any additional movement in that offer").

[8] J.A. 231 (Drewer testimony); see also J.A. 378 (Johnson testimony) ("I was primarily concerned with the interests of the minority stockholders"); J.A. 275 (testimony of Sidney O. Dewberry) ("I clearly understood my obligations * * * [t]o see that the stockholder[s] got a fair price for their stock"); J.A. 369 (Smith testimony) ("My interest was for the minority stockholders, of which I was one").

[9] "[O]ur responsibility [was] to be doubly sure that we got a fair price and that we had to take special consideration of the minority stockholders on both sides, one that we get a fair price on the high side, that we could there, but at the same time that we not be overzealous and the deal might fall through and that we might harm the stockholders who felt a real need to sell and thought $42 was—and they just wanted that price."

J.A. 231 (Drewer testimony). See also J.A. 257 (Baker testimony) ("it was an excellent opportunity for the minority stockholders").

to effectuate the merger without consent of any minority shareholders. See Va. Code Ann. § 13.1-718E. Nonetheless, the proxy statement contained 35 pages of detailed information about the merger. Pet. App. 34a-76a.

The proxy statement reported that the merger "has been approved by the Board of Directors because it provides an opportunity for the Bank's public shareholders to achieve a high value for their shares. The price to be paid is about 30% higher than the $32.50 per share at which the Bank's common stock traded on February 8, 1987, the last trading day prior to the announcement of the proposal." Pet. App. 53a-54a. In explaining how the Board had determined that the $42 per share offer was "fair to * * * shareholders," the proxy statement described a variety of objective economic factors that the Board had reviewed. *Id.* at 37a, 53a-54a. The statement also explained that "FABI's Board of Directors commissioned Keefe, Bruyette & Woods, Inc., an independent investment banking firm, to pass on the fairness of the Merger from a financial point of view." *Id.* at 38a. After setting forth KBW's qualifications to evaluate the shares, the proxy statement described in detail the terms of KBW's engagement and the fact that KBW had been engaged by FABI—not by the Bank:

> "For rendering its opinion to FABI, Keefe, Bruyette & Woods, Inc. will be paid $25,000, and if the Merger is consummated, will be paid an additional fee of $75,000. In addition, FABI will reimburse Keefe, Bruyette & Woods, Inc. for all of its reasonable out-of-pocket disbursements and expenses and has extended to Keefe, Bruyette & Woods, Inc. indemnification arrangements usual in such engagements."

Id. at 55a. The full terms of KBW's engagement and compensation also were set forth in KBW's opinion letter, which was attached to the proxy statement. *Id.* at 74a-76a.

To inform minority shareholders of facts that might be deemed relevant in assessing the Board's recommendation on the issue of financial fairness, the proxy state-

ment revealed that the "Bank has had, and expects to have in the future, banking transactions in the ordinary course of its business with directors." Pet. App. 51a. The proxy statement also clearly disclosed—in three separate places—that the "Board of Directors of the Bank as comprised prior to the Effective Date of the Merger will continue to serve as the Board of Directors of the Resulting Bank." *Id.* at 59a; see also *id.* at 55a-56a, 38a.

At the April 21, 1987 meeting of the shareholders, the merger received overwhelming approval by 97% of the shares voted. In addition to FABI's votes, over 70% of the minority shares were voted in favor of the proposal. J.A. 65-66, 249-250.

D. The State Court Litigation.

Not all shareholders were satisfied with the price they would receive under the merger plan. Shortly after the proxy statement was sent out, a group of 15 shareholders, led by respondent Paul H. Weinstein, filed a protest before the Virginia Corporation Commission. In a detailed submission to the Commission, they raised an array of objections to the merger, including allegations that the $42 price was unfair to the minority shareholders and that the Bank's directors had breached their fiduciary duty by recommending the merger. J.A. 29-36. The Commission refused to entertain these claims and approved the merger, finding that because a "benefit to the public's interest may result therefrom and no detriment to the public will ensue, the Commission is of the opinion and finds that granting the required certificates will be in the public interest." J.A. 38-39.

Six days before the scheduled meeting of shareholders, Weinstein and 12 other shareholders filed an action in the Circuit Court of Fairfax County, Virginia, seeking to enjoin the meeting and the merger and also seeking an appraisal remedy. The plaintiffs alleged, *inter alia*, that "[t]he $42 per share that defendants propose to pay complainants * * * is far less than the true value of the

shares." J.A. 9. The complaint, which was based on information set forth in the proxy statement, alleged that the directors engaged in deceptive practices and were subject to a conflict of interest, and accused them of improperly relying on the KBW assessment because they "failed to conduct any independent investigation of the fairness of the proposed Merger and, specifically, failed to retain any independent financial advisor to advise the Directors as to the fairness of the plan." J.A. 10, 6-14.

The Virginia court denied relief, noting that it lacked power to "stop this merger without a showing of fraud." J.A. 21. See Va. Code Ann. § 13.1-614 (barring injunctive relief against corporate meetings and transactions in the absence of fraud). Moreover, the court explained that the Virginia General Assembly "chose to balance the competing interests of minority stockholders versus those of the depositing public" by withholding an appraisal remedy for dissenting shareholders in bank mergers, and ruled that "[c]omplainants may not obtain that which the legislature has taken away by masking their request as the enforcement of an equitable duty." Pet. App. 32a-33a. In light of this decision, which the Virginia Supreme Court later declined to review, the annual meeting proceeded as planned.

E. The Federal Court Litigation.

On March 14, 1988, another shareholder, respondent Doris I. Sandberg, appearing through the same counsel, filed a class action in the United States District Court for the Eastern District of Virginia. Much like the previous state law complaint, the federal complaint alleged breach of fiduciary duty based on the supposed inadequacy of the $42 per share received by the minority shareholders. But this complaint also alleged that FABI, VBI, and the individual directors of the Bank had violated Section 14(a) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78n(a), by issuing a proxy statement that "contained misstatements of material fact and

failed to disclose material facts necessary to make the statements made not misleading." J.A. 49.[10]

The district court refused to certify a class of minority shareholders and also declined to allow a group of plaintiffs, led again by respondent Weinstein, to intervene in the *Sandberg* litigation. The federal claim therefore proceeded to trial as an individual action involving a shareholder who owned 2,442 shares and who claimed that the proxy statement contained six misstatements concerning the merger transaction. Pet. App. 15a-17a. The jury returned a general verdict for respondent Sandberg on the federal count in the amount of $43,956, or $18 per share. On the state law claim of breach of fiduciary duty, the jury found in favor of the two corporate defendants but against the individual Bank directors, assessing damages in the same amount.

While the *Sandberg* litigation was pending, a group of 67 plaintiffs who owned 182,902 shares, led once again by respondent Weinstein and represented by the same counsel, filed a separate action in federal court. After the *Sandberg* verdict was rendered, these plaintiffs moved for summary judgment, asking the court to apply the doctrine of non-mutual offensive collateral estoppel. Over petitioners' objections, the district court applied this doctrine and granted summary judgment for these plaintiffs, awarding them the $18 a share that the jury had awarded respondent Sandberg, for a total of $3.3 million. Pet. App. 28a-29a.[11]

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[10] Section 14(a) makes it unlawful to solicit a proxy "in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe." Section 12(i) of the Act, 15 U.S.C. § 78*l*(i), empowers the Federal Deposit Insurance Corporation to "administer and enforce" Section 14(a) as applied to proxy solicitations of banks insured and regulated by the FDIC. The antifraud provision promulgated by the FDIC, 12 C.F.R. § 335.206, is set forth in the appendix to this brief.

[11] The court similarly granted summary judgment on the state law claims, but because of Virginia's statutory limit on directors' liability, this alternative award was limited to $2.3 million. See Va. Code Ann. § 13.1-692.1.

F. The Decision of the Court of Appeals.

The Fourth Circuit affirmed the *Sandberg* judgment and the grant of summary judgment in *Weinstein*. It held that two of the six alleged misstatements that had been presented to the jury could support liability under Section 14(a).

The court of appeals first ruled that the proxy statement falsely described the motives and beliefs of the Bank's directors, who had recommended the merger on the ground "that the $42 offer was fair to the minority stockholders" and represented a "high value for their shares." Pet. App. 15a-16a. The court reasoned that this expression of opinion was misleading because it did not reveal the "real" motivations of the directors. *Id.* at 15a. According to the court, "the jury was certainly justified in believing that the directors did not believe a merger at $42 per share was in the minority stockholders' interest but, rather, that they voted as they did for other reasons, *e.g.*, retaining their seats on the board." *Ibid.* The court held that "[w]e cannot say that the directors' recommendation that the $42 offer was fair to the minority stockholders was * * * not a material misrepresentation." *Id.* at 16a.

The court of appeals next ruled that it was deceptive for the proxy statement to characterize KBW as "an independent investment banking firm." Citing the contingent compensation agreement between FABI and KBW and the fact that KBW received its information on the issue of financial fairness from FABI, the court asserted that a representation that KBW made "an independent determination could certainly have been found to be a material misrepresentation." Pet. App. 16a.

The court of appeals also deemed it irrelevant that respondent Sandberg "admitted lack of reliance" on the allegedly misleading proxy statement and that the minority shareholders had no means of blocking the merger. Pet. App. 11a. Under Virginia law, FABI's ownership of 85% of the Bank's shares gave it the right to effect the merger even if every one of the minority share-

holders voted against it.[12] Although the court of appeals recognized that this Court previously left open the question whether causation could ever be established under these circumstances, see *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 385 n.7 (1970), the court proceeded to announce a rule that entirely dispensed with any need to show causation. Pet. App. 12a-14a. The Fourth Circuit declared that "if the proxy statement contained material misrepresentations and was an essential link in the merger, § 14(a) liability may be established" even though the individual plaintiff could not prove "reliance" on the proxy statement and even though "the minority's voting strength is insufficient to halt [the] merger." *Id.* at 14a. The damages caused by the allegedly erroneous statements in the proxy solicitation, the court ultimately concluded, were the difference between the price the minority shareholders actually received ($42 per share) and the price asserted by respondents' expert witness to represent the stock's "inherent value" ($60 per share). *Id.* at 20a.

On respondent Sandberg's cross-appeal, the court of appeals reversed the district court's refusal to certify a class of all minority shareholders. The result of this ruling is that the $43,956 judgment that the jury awarded to respondent Sandberg may be transformed on remand into a judgment in excess of $13 million. Pet. App. 11a.[13]

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[12] The proxy statement expressly informed shareholders that "the Plan of Merger must be approved by the vote of more than two-thirds of the outstanding Bank common stock entitled to vote. Because Virginia Bankshares owns more than the requisite minimum and has indicated its intention of voting for the Plan of Merger, the Bank's Board of Directors expects the Plan of Merger to be approved." Pet. App. 52a.

[13] The liability of the individual directors on the state law claims is subject to a statutory cap and cannot exceed $2.3 million, no matter how large the class. See note 11, *supra*. Because the directors' liability under the federal count is greater than under the state law count, and because the corporate petitioners were exonerated under the state law count, it is clear that the judgments below cannot be sustained on state law grounds alone.

SUMMARY OF ARGUMENT

I.

Federal regulation of corporate proxy solicitations plays an important role in the Nation's system of corporate governance. By requiring persons who solicit proxies to inform shareholders of material facts relevant to their votes, these laws ensure that shareholders have a fair understanding of issues they are called upon to decide. With the facts in hand, shareholders need not place blind trust in the recommendations of others. Rather, each shareholder has the opportunity to evaluate those recommendations to determine whether they comport with the shareholder's own judgment and individual interest.

Federal regulation of the truthfulness of facts set forth in proxy statements is not, however, a mandate for second-guessing indefinite opinions and characterizations, or for reviewing the subjective motivation of corporate directors. Such opinions and characterizations are, on their face, imprecise expressions of viewpoint that invite shareholders to form their own judgments. If indefinite expressions such as these were subject to review by a jury, the drafters of proxy statements—including both corporate managers and dissident shareholders seeking to solicit proxies—would have little practical guidance as to how to satisfy the law.

There is no statutory or regulatory foundation for imposing liability on such a speculative and indeterminate basis. Nothing in the Securities Exchange Act of 1934 or in any regulation suggests that federal courts and juries are empowered to scrutinize proxy statements to second-guess word choices and expressions of subjective opinion, or to psychoanalyze the motives of those who recommend corporate transactions. To the contrary, the governing FDIC regulation prohibits only misstatements or omissions of "material fact." 12 C.F.R. § 335.206. Not surprisingly, appellate courts applying the antifraud provisions of the federal securities laws repeatedly have

refused to penalize expressions of subjective opinion or use of indefinite characterizations in cases such as this one.

The erroneous construction of federal proxy law adopted by the court of appeals—which permits juries to speculate about motivation and to exercise editorial review over adjectives appearing in proxy statements—threatens to obliterate the boundary line between federal and state jurisdiction in stockholder suits, as defined by this Court in *Santa Fe Industries* v. *Green*, 430 U.S. 462, 478-479 (1977). The court's construction also threatens to impair the quality of disclosure by compelling the drafters of proxy statements to interject exculpatory rhetoric that will distract shareholders and obscure the presentation of material facts. Ultimately, the censorious form of review endorsed by the court below would operate as an obstacle to meaningful communication between managers and shareholders on fundamental issues of corporate policy. Contrary to the purpose of the federal securities laws, corporate debate would be stifled under an oppressive regime of vague legal standards combined with open-ended class-action damages liability.

Even if some indefinite characterizations or opinions could give rise to liability under federal proxy law, this is plainly not such a case. The opinions and characterizations in the proxy statement were completely truthful, given the ordinary, natural meaning of the words "fair" and "independent." Moreover, the proxy statement disclosed all of the objective facts necessary to allow shareholders to assess for themselves whether these adjectives accurately described the directors' recommendation and the status of the investment banking firm. Shareholders who wished to infer the existence of a conflict of interest or ulterior motivation on the part of the directors or KBW were fully equipped to do so. No reasonable shareholder could have been misled by the proxy statement. Significantly, respondents depended on facts disclosed in the proxy statement to establish their claims in state court. They produced no evidence that any shareholder

was in fact misled, and both named plaintiffs admitted that they were *not* misled.

II.

Even if this Court were to conclude that the proxy statement contained misstatements of "material fact," respondents would not be entitled to recover damages unless they also could demonstrate that the alleged misstatements *caused* them cognizable injury. In this case, the jury was never asked to find any causal link. Moreover, it is clear that respondents did not (and could not) satisfy their burden of establishing causation. The court of appeals acknowledged as much when it dispensed with the requirement of proof of causation.

Federal proxy legislation is designed to protect the right of shareholders to influence the outcome of corporate elections by use of their voting power. To recover damages under the proxy law, therefore, a plaintiff must prove injury resulting from interference with shareholder voting. Here, however, respondents could not possibly demonstrate any effect on voting results. Because the majority shareholder owned 85% of the shares —far more than the two-thirds necessary to approve the merger—the merger would have been approved even if every single minority shareholder had voted against it. It was this lack of voting power that precluded respondents from voting down the merger. Nothing contained in the proxy statement affected that result.

This total absence of voting-related injury should be the end of the causation inquiry. But even if the Court were inclined to allow a plaintiff to recover under the proxy law on some other theory of causation, respondents could not qualify for a damages award here. Although some courts have permitted minority shareholders to attempt to prove that, had they known the facts, they could have obtained injunctive relief in state court, the record in this case conclusively shows that respondents failed to stop the merger between FABI and the Bank. Relying on essentially the same factual allegations that underlie the instant action, respondents tried to enjoin the merger

in state court and before the Virginia Corporation Commission on grounds of breach of fiduciary duty, conflict of interest, and deception. But those bodies held that no case was stated for injunctive relief under Virginia law.

By the same token, it would be impossible for respondents to establish causation by asserting that fuller disclosure might have generated adverse publicity and forced the Bank and its 85% shareholder to abandon the merger. That causation theory is inherently conjectural and speculative. In addition, it finds no support in the facts of this case. The merger was authorized by state statute regardless of minority shareholder dissent, and it received regulatory approval notwithstanding vociferous objections from a group of minority shareholders. The merger not only promised to improve the Bank's competitive performance but also offered minority shareholders a 30% premium above the market value of their shares. In these circumstances, any claim that "adverse publicity" would have aborted the merger cannot be taken seriously.

The reason that respondents cannot—and did not even attempt to—demonstrate that they were injured by the proxy statement is that the damages alleged in this case have nothing to do with the proxy solicitation process. Respondents' grievance is over the amount of money they received in the merger, not with the disclosures contained in the proxy statement. Because Virginia law establishes liability limitations that they hope to evade, respondents have sought to replead their state law cause of action as a federal action for securities fraud. But that exercise in artful pleading cannot obscure the fundamental defect in their causation theory: nothing contained in the proxy statement was found or could plausibly have been found to have impaired respondents' ability to halt the merger or to increase the premium paid for their shares.

ARGUMENT

I. PERSONS WHO SOLICIT PROXIES MAY NOT BE HELD LIABLE UNDER FEDERAL PROXY LAW FOR EXPRESSION OF SUBJECTIVE OPINIONS OR USE OF INDEFINITE CHARACTERIZATIONS WHERE THE UNDERLYING MATERIAL FACTS ARE FAIRLY DISCLOSED.

This Court consistently has recognized that the federal securities laws were not designed to federalize the "wide variety of corporate conduct traditionally left to state regulation." *Santa Fe Industries* v. *Green*, 430 U.S. 462, 478 (1977). In corporate merger cases such as this one, the focus of the federal securities laws is on the adequacy of disclosure of material facts; once information is "fairly presented" that would enable shareholders to decide for themselves whether to "accept the price offered" (*id.* at 474), the "fairness of the terms of the transaction" is not a concern of federal law (*id.* at 478).

In this case, the Fourth Circuit ignored these principles and sustained liability that could exceed $13 million based on opinions and characterizations appearing in a proxy statement, even though the proxy statement presented all of the underlying facts necessary for shareholders to form their own judgments about the merger and its financial fairness. In essence, the court of appeals reasoned that the proxy statement was deceptive because the directors did not accuse themselves of breaching their fiduciary duty under state law and did not accuse the investment banker that rendered a fairness opinion of relinquishing its independence. The federal securities laws do not, however, require this kind of self-castigation, or permit a windfall judgment to be predicated on proxy statements that could not possibly have misled any rational investor.

A. Opinions And Characterizations That On Their Face Are Indefinite And Unverifiable Expressions Cannot Constitute Misstatements Of Material Fact Under Section 14(a).

The Fourth Circuit identified two expressions in the proxy statement that, in its view, violated Section 14(a). First, the court held that the statement that the directors recommended the merger as "fair" to minority stockholders was false because "the jury was certainly justified in believing that the directors did not believe a merger at $42 per share was in the minority stockholders' interest but, rather, that they voted as they did for other reasons, *e.g.*, retaining their seats on the board." Pet. App. 15a. Second, the court held that the characterization of KBW as "independent" was false because KBW had discussed the issue of fair price with personnel at FABI and was compensated by FABI on a contingent basis. *Id.* at 16a. The court below plainly erred, however, in predicating Section 14(a) liability on representations in the proxy statement that the merger price was "fair" or that KBW was "independent." It is well established that federal proxy law does not permit juries to second-guess the use of expressions that, on their face, are indefinite and subjective in nature, or to speculate about the motivation of members of a board of directors.

The applicable antifraud regulation of the FDIC prohibits any misstatement of a "material fact" or omission to state a "material fact" necessary to make affirmative representations not false or misleading. See 12 C.F.R. § 335.206; see also 17 C.F.R. § 240.14a-9 (SEC counterpart). This unambiguous focus on *statements of material fact*—as opposed to indeterminate and unverifiable expressions of opinion or subjective motivation—reflects the established rule at common law.[14] These regulations

[14] See, *e.g.*, *Presidio Enterprises* v. *Warner Bros.*, 784 F.2d 674, 678-679 (5th Cir. 1986) ("actions for fraud or misrepresentation must be based on objective statements of fact, not expressions of personal opinion. The law wisely declines to tread in the latter area

should not be given a broader reading than their literal language admits. See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197, 201 (1976). The regulations show on their face that they require "nothing more than the disclosure of basic facts so that outsiders may draw upon their own evaluative expertise in reaching their own investment decisions." *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) (*en banc*).

The detailed schedule of items for disclosure set forth in the FDIC's regulation also refutes any suggestion that it was designed to police the sincerity of expressions of subjective opinion or the use of indefinite adjectives or characterizations. The FDIC regulation lists 22 specific items that proxy statements must reveal. See 12 C.F.R. § 335.212; see also 17 C.F.R. § 240.14a-3 (SEC counterpart). This precisely-calibrated disclosure rule is designed to permit investors to draw their own conclusions about the potential self-interest of directors. For example, item 4 requires a brief description of "any substantial interest, direct or indirect, by security holdings or otherwise" of bank directors making a proxy solicitation. Item 7 requires disclosure of "remuneration" and other transactions between the bank and the directors. Rather than requiring speculation about subjective state of mind or forbidding the use of indeterminate characterizations such as "fair" or "independent," the regulation calls for disclosure of objective factual information. Once that information is fairly set forth, shareholders are free to make their own judgments about matters such as the "fairness" of transactions or the "independence" of corporate advisers.

The conclusion that federal proxy law requires courts to distinguish between "material facts," on the one hand,

because * * * 'everyone is entitled to his own opinion.' * * * A statement of fact is one that (1) admits of being adjudged true or false in a way that (2) admits of empirical verification"); *Bulgo* v. *Munoz*, 853 F.2d 710, 716 (9th Cir. 1988) ("an actionable misrepresentation must relate to fact and cannot be based on an expression of opinion"); *Ward* v. *Succession of Freeman*, 854 F.2d 780, 791 (5th Cir. 1988) ("motive is not a material 'fact' ").

and indefinite, unverifiable "opinions" or "characterizations," on the other, is supported by more than the plain language of the controlling statute and regulation. Crossing the line between objective facts and subjective opinions or characterizations would have multiple adverse effects on the regulation of proxy statements.

1. *Confusion of legal standards.* Disregard of the governing regulation's focus on "material fact" would leave courts, enforcement officials, and businesses seeking to comply with the securities laws in a state of hopeless uncertainty and would lead to unprincipled and unpredictable liability. It is practicable to determine whether an objective fact in a proxy statement is true or false; it is quite another matter, however, to determine the veracity of an indefinite characterization, such as "independent," or a statement of subjective opinion, such as whether the directors truly believed that a merger was "fair." [15]

A "fairness" opinion is dependent upon an assessment of a host of different and necessarily subjective considerations that do not admit of a "correct" answer. Similarly, the question of what subjective factors entered into any individual director's decision to assess a corporate transaction as "fair" (see notes 4-9, *supra*)—much less the decision of an entire board of directors (which here included 22 members)—opens up speculative issues that courts are ill-equipped to resolve.[16] As the

[15] The practical impediment to adjudication of the veracity of indefinite opinions and characterizations such as "fair" and "independent" is shown by examination of the dictionary meaning of those terms. The adjective "fair" has at least 11 accepted definitions, each with its own meaning, and a multitude of subdefinitions, ranging from "moderately * * * large," or "sufficient" to "free from fraud," "equitable," and "having a certain basis in evidence or of reason." *Webster's Third New International Dictionary* 815 (1971). The adjective "independent" has an equally broad and diverse spectrum of meanings. *Id.* at 1148; see pp. 33-34, *infra*.

[16] The speculative nature of this issue is well characterized by respondent Weinstein's deposition testimony (J.A. 61):

court pointed out in *Data Probe Acquisition Corp.* v. *Datatab, Inc.*, 722 F.2d 1, 5 (2d Cir. 1983), a subjective inquiry into director "motivation" erroneously "assumes that boards of directors have monolithic viewpoints." The practical need to avoid such "hazy issues" is "entitled to a good deal of weight" in construing implied causes of action under the antifraud provisions of the federal securities laws. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 743, 755 (1975). See also *Dirks* v. *SEC*, 463 U.S. 646, 658 n.17 (1983) (rejecting an expansive interpretation of the securities laws that would be "inherently imprecise, [because] imprecision prevents parties from ordering their actions in accord with legal requirements"); *Pinter* v. *Dahl*, 486 U.S. 622, 654 n.29 (1988) (warning against the "risks [of] overdeterring activities related to lawful securities sales" as a result of judicial creation of open-ended legal standards that "produce[] unpredictable results").

2. *Impairment of disclosure statements.* If Section 14(a) liability could be based upon disagreements over unverifiable opinions and characterizations, or speculations about subjective motivation, the statute would require issuers either to forego certain transactions altogether or to fill proxy statements with caveats, qualifications and self-accusations, the practical effect of which would be to make such statements less accurate and virtually incomprehensible to all but the most sophisticated investors. This Court warned in *TSC Industries* v. *Northway, Inc.*, 426 U.S. 438, 448-449 (1976), that the "disclosure policy embodied in the proxy regulations is not without limit." The Court explained that "management's fear of exposing itself to substantial liability" based on unreasonable disclosure rules "may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to in-

"Q. What evidence do you have that the directors were making their decision based on some other reason, for instance, their own interest?

A. It would all be conjecture."

formed decisionmaking." *Ibid.* This concern applies even more strongly here. The Fourth Circuit has awarded millions of dollars in damages based on speculations about the subjective beliefs of corporate directors and quarrels over the choice of adjectives used in a proxy statement. The drafters of proxy statements have no means to anticipate or avoid such liability. The effect of this open-ended regime of liability will be to severely chill the expression of opinions and use of characterizations in proxy statements, while forcing draftsmen to interlard such documents with exculpatory and wholly unilluminating declarations designed to minimize the danger of ruinous damages awards.

If liability could be predicated on the subjective motivation of individual directors, a prudent draftsman of the proxy statement at issue in this case would have been obliged to interrogate each of the 22 directors of the Bank and examine each as to his or her "true" reasons for approving the merger. Even that daunting task—more appropriate for a psychoanalyst than a corporate lawyer—would provide no immunity from liability, because the Fourth Circuit would permit the jury to make its own determination whether the directors told the truth, or, in fact, held ulterior motivations. Under the Fourth Circuit's rationale, virtually *every* proxy statement would be subject to attack for nondisclosure or inaccurate disclosure of motives, no matter how complete its disclosure of objective, material facts.

Fear of unbounded liability has already produced disclosure documents that are verbose, legalistic, and difficult for the average investor to comprehend. "From the point of view of nonprofessional recipients of disclosure, overwhelming verbosity in prospectuses is still a problem. Even for professionals, the relative significance of important disclosures can be lost in a sea of self-lacerating prose." Herzel & Shepro, *Setting the Boundaries for Disclosure*, 16 Sec. Reg. L.J. 179, 185-186 (1988). See also Easterbrook & Fischel, *Mandatory Disclosure and the*

Protection of Investors, 70 Va. L. Rev. 669, 678-679 & n.16, 708-709 (1984) (referring to "obfuscatory" boilerplate in disclosure documents); accord, H. Kripke, *The SEC and Corporate Disclosure* 268-270, 275, 281-282 (1980). As it has in the past, this Court should reject a radical extension of the scope of implied remedies under the federal securities laws that would generate serious practical burdens and unnecessarily encumber the disclosure process. See, *e.g.*, *Piper* v. *Chris-Craft Industries*, 430 U.S. 1, 40 n.26 (1977) ("[t]he legal uncertainties that inevitably pervade this area of the law call into question whether 'deterrence' of § 14(e) violations is a meaningful goal, except possibly with respect to the most flagrant sort of violations which no reasonable person could consider lawful").[17]

3. *Subversion of federalism principles.* The Fourth Circuit's sweeping decision also erases the boundary-line between state and federal jurisdiction in stockholder disputes and transforms virtually every claim of breach of fiduciary duty in the merger context into a federal securities claim. Through artful pleading, resourceful litigants can now allege that almost any explanation of corporate action is false and misleading because it does not reveal the directors' "real" motivation (Pet. App. 15a), because it does not confess a breach of fiduciary duty in taking action shareholders believe to be wrong, or simply because shareholders disagree with management's stated opinions on economic issues. Under the reasoning of the Fourth Circuit, juries would be empowered to evaluate the subjective motivation of directors and the "fairness"

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[17] Unpredictable securities law liabilities based on haphazard evaluation of proxy statements would have a deterrent effect on the communications not only of corporate incumbents, but also of insurgents seeking corporate governance reform. See E. Aranow & H. Einhorn, *Proxy Contests for Corporate Control* 12-13, 27, 470-474 (1968) (describing litigation burdens shouldered by insurgents seeking to solicit proxies). See also Easterbrook & Fischel, *Voting in Corporate Law*, 26 J.L. & Econ. 395, 422 (1983) (noting that litigation burdens "increase costs, which in turn decreases the incentive of potential insurgents to engage in proxy fights").

of mergers under the guise of passing on the accuracy of factual disclosures in proxy statements. Similarly, by permitting juries to gauge the degree of independence exercised by investment banking firms, the court has authorized juries to probe the thought processes of financial advisers and to effectively review the performance of fiduciary duty by corporate directors who give weight to the recommendations of such advisers. Thus, the court below has authorized juries in federal proxy cases to make the very determinations called for by state law in suits seeking damages for breach of fiduciary duty or an appraisal.[18]

This Court's decision in *Santa Fe Industries* v. *Green*, 430 U.S. 462, 478-479 (1977), forecloses recognition of an implied cause of action that overrides the traditional boundary line between state and federal jurisdiction. In *Santa Fe*, the Court refused to expand the scope of the securities laws to embrace the fairness of a "freeze-out merger," noting that "[t]he result would be to bring within the Rule a wide variety of corporate conduct traditionally left to state regulation. In addition to posing a 'danger of vexatious litigation which could result from a widely expanded class of plaintiffs' * * * this extension of the federal securities laws would overlap and quite possibly interfere with state corporate law." *Ibid.* The Court reiterated that "we are reluctant to federalize the substantial portion of the law of corporations that deals

[18] The SEC warned against that result in *Franchard Corp.*, Securities Act Release No. 4710, [1964-1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,113, at 82,046-82,048 (July 31, 1964): "To generally require information in Securities Act prospectuses as to whether directors have performed their duties in accordance with the standards of responsibility required of them under state law would stretch disclosure beyond the limitations contemplated by the statutory scheme and necessitated by considerations of administrative practicality. * * * * In our view, this is a function which the disclosure requirements of the Securities Act cannot effectively discharge. It would either result in self-serving generalities of little value to investors or grave uncertainties both on the part of those who must enforce and those who must comply with that Act."

with transactions in securities, particularly where established state policies of corporate regulation would be overridden." *Ibid.* Accord, *Business Roundtable* v. *SEC*, No. 88-1651 (D.C. Cir. June 12, 1990), slip op. 8-11 (discussing legislative history demonstrating that the proxy laws were never intended "to interfere in the management of corporations").

This case provides a concrete example of how a sweeping extension of Section 14(a) can undermine and subvert state corporation law. Concerned about the adverse effects of unlimited directors' liability, Virginia amended its corporation laws in 1987 to place a cap on directors' civil liabilities. See Va. Code Ann. § 13.1-692.1. Under the terms of Virginia's statute, if a director were to breach a fiduciary duty, his liability cannot exceed the greater of $100,000 or his annual compensation from the corporation. Even though the Fourth Circuit recognized that this damages cap applies precisely to the case at hand (Pet. App. 23a), it overrode the damages limitation by expansion of the implied remedy under the federal securities laws. At the same time, by awarding all minority shareholders what it deemed to be the "inherent value" of their shares in this class action proceeding (*id.* at 20a), the court effectively granted the appraisal remedy that Virginia has deliberately withheld as a matter of state banking policy. See also ACCA Amicus Br. (describing director liability restrictions in 37 states). It is difficult to conceive of a more intrusive "interference" with state corporation law.

4. *Harm to freedom of speech.* The Fourth Circuit's draconian ruling, imposing liability under Section 14(a) based on subjective opinions and characterizations in a proxy statement, needlessly generates tension between the securities laws and the First Amendment. As this Court has frequently noted, "[i]t is our settled policy to avoid an interpretation of a federal statute that engenders constitutional issues if a reasonable alternative interpretation poses no constitutional question." *Gomez* v. *United States*, 109 S. Ct. 2237, 2241 (1989). Constitutional concerns

can easily be avoided here by limiting Section 14(a) liability to false or misleading statements of material *fact*.

Even in the commercial speech area, government restrictions on communication "may be no more broad or no more expansive than 'necessary' to serve [the government's] substantial interests" (*Board of Trustees* v. *Fox*, 109 S. Ct. 3028, 3032 (1989)) because "the free flow of commercial information is * * * indispensable to the proper allocation of resources." *Virginia Pharmacy Board* v. *Virginia Consumer Council*, 425 U.S. 748, 765 (1976). But communications through proxy statements are not mere commercial speech. They do "more than propose a commercial transaction." *Posadas de Puerto Rico Associates* v. *Tourism Co.*, 478 U.S. 328, 340 (1986). Proxy solicitations are the means by which managers and shareholders communicate with each other in order to chart the future course of their companies and to debate important issues of corporate governance. Thus, proxy statements can be as "political" as debate over divestiture of assets in South Africa or the election of a board of directors. See *SEC* v. *Medical Committee for Human Rights*, 404 U.S. 403 (1972); see also Pet. App. 45a-50a.

In this process, it is essential that participants have reasonable latitude to express opinions and utilize their own choice of words without unpredictable and censorious editorial review. See *Milkovich* v. *Lorain Journal Co.*, No. 89-645 (June 21, 1990), slip op. 19 (distinguishing, for First Amendment purposes, between statements that are "sufficiently factual to be susceptible of being proved true or false" on the basis of "objective evidence," and mere "subjective assertion"). Unless subjective opinions and characterizations are left to the discretion of each speaker, corporate debate—and corporate democracy—will be stifled.

This Court recognized in *Lowe* v. *SEC*, 472 U.S. 181 (1985), that the federal securities laws should be construed in light of First Amendment principles. The Court

observed that "because we have squarely held that the expression of opinion about a commercial product * * * is protected by the First Amendment * * * it is difficult to see why the expression of an opinion about a marketable security should not also be protected." *Id.* at 210 n.58. In a concurring opinion, Justice White, joined by Justice Rehnquist and Chief Justice Burger, stressed that the First Amendment forbids "drastic" remedies that obstruct legitimate communication. *Id.* at 234-235. Although the imposition of a multi-million dollar damages award is not a prior restraint on speech, as considered in *Lowe*, the chilling effect of unleashing such private remedies without ascertainable standards or limitations will, as a practical matter, exert an even more drastic impact on corporate communications.

Knowledgeable commentators have demonstrated that unduly expansive constructions of the federal proxy rules threaten fundamental First Amendment freedoms.[19] Those concerns apply directly here and provide additional reason to overturn the massive damages award that the Fourth Circuit has predicated on the expression of subjective opinion and the use of an indefinite characterization in the proxy statement now before the Court.

B. Even If Some Characterizations Or Opinions Could Support Liability Under Section 14(a), The Expressions In This Case Cannot Because They Were Accompanied By Objective Facts That Enabled Shareholders To Make Their Own Evaluations.

We have explained above that the language and purpose of the federal securities laws would be perverted if liability could be imposed under Section 14(a) based not

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[19] See, *e.g.*, Wolfson, *The First Amendment and the SEC*, 20 Conn. L. Rev. 265, 283 (1988) ("shareholders and management should enjoy the strong version of first amendment protection in their speech dealing with the governance of that significant element in American life"); BeVier, *A Comment on Professor Wolfson's "The First Amendment and the SEC,"* *id.* at 325, 345 ("The Commission's regulation of proxy solicitations may be the most vulnerable to constitutional challenge").

upon misstatements of material fact but upon disagreements with opinions and characterizations appearing in proxy statements. But even if *some* opinions or characterizations might warrant a finding that Section 14(a) has been violated, it would be impossible to reach that conclusion on the facts of this case. In both instances identified by the court of appeals, the proxy statement fully and fairly set forth the basis for the directors' opinions and characterizations. Once the material *facts* on which opinions and characterizations are predicated have been disclosed, "shareholders will presumably decide for themselves what weight to accord the opinions." *Radol* v. *Thomas*, 534 F. Supp. 1302, 1316 (S.D. Ohio 1982).

1. *The "fairness" of the merger.* The Fourth Circuit determined that it was false and misleading for the directors to recommend the merger on the ground that the buyout price was "fair" and offered a "high value" for minority shares, reasoning that the directors may have "voted as they did for other reasons, *e.g.*, retaining their seats on the board." Pet. App. 15a-16a. But no shareholder could possibly have been misled by the directors' opinion on the issue of financial fairness. The proxy statement set forth specifically what the directors meant when they said the price was "high" and "fair," referring to the fact that the "price to be paid is about 30% higher than the $32.50 per share at which the Bank's common stock traded on * * * the last trading day prior to announcement of the proposal," and that the price "represents a premium of approximately 26% over the book value of the common stock at such date." *Id.* at 53a-54a. Fairness is in the eye of the beholder, and shareholders were free to agree or disagree about the sufficiency of the merger price based on their view of the adequacy of this premium.

Similarly, shareholders received explicit information that permitted them to draw their own conclusions as to whether the directors labored under a conflict of interest in rendering their opinion on financial fairness. The proxy statement disclosed that the directors also were

customers of the Bank and that they expected to continue to transact business with the Bank. In addition, the statement disclosed not once—*but three separate times*—that the directors would retain their seats on the board of directors under the merger plan. Pet. App. 38a, 55a-56a, 59a ("[a]fter the Effective Date of the Merger, the Board of Directors of the Resulting Bank will consist of the members of the Board of Directors of the Bank immediately preceding the Effective Date of the Merger"). Shareholders who wished to discount the directors' opinion because the directors may have desired to "retain[] their seats on the board" were therefore fully able to do so.

The Fourth Circuit never questioned the accuracy of these factual disclosures. Rather, it concluded that Section 14(a) was violated because the directors may secretly have harbored a different and purely selfish motive for stating that the merger was "fair" and because they failed to accuse themselves of that misconduct in the proxy statement. The courts are in agreement, however, that a plaintiff's allegation of a "failure to disclose * * * the 'true' motivations of the directors * * * states no cause of action under the 1934 Act." *Kas* v. *Financial General Bankshares, Inc.*, 796 F.2d 508, 513 (D.C. Cir. 1986). Federal securities laws are "not concerned that [defendants] made a statement that, if the plaintiffs were correct, was misleading since it was not the *true* reason management opposed the tender offer." *Kademian* v. *Ladish Co.*, 792 F.2d 614, 624 (7th Cir. 1986).[20]

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[20] It would be particularly unfair to impose liability on such a conjectural basis in this case, where some of the directors were foreclosed from testifying (J.A. 375). Even with respect to those directors who did testify, the speculative nature of the inference indulged by the court of appeals is manifest. For example, George W. Johnson, a Bank director who is also President of George Mason University, testified simply that he learned of FABI's interest in the merger, that his decision was addressed to "the interests of the stockholders," and that he relied on the KBW presentation as well as the book value and market value of the stock in deciding that $42 was a fair price. J.A. 278-281. Yet Johnson, along with

Other circuits that have considered the issue have reached the identical conclusion. See, *e.g.*, *Biesenbach* v. *Guenther*, 588 F.2d 400, 401-402 (3d Cir. 1978) (there is no liability for an allegedly false statement that proposed transactions "were in the best interests of the shareholders and were designed to protect shareholders' financial interests"); *Field* v. *Trump*, 850 F.2d 938, 947 (2d Cir. 1988) (rejecting "[e]fforts to dress up [state-law claims] in a § 14(a) suit of clothes * * * [by] including allegations of * * * failure to disclose an alleged ulterior motive"); *Kas*, 796 F.2d at 513-515 ("federal securities laws do not impose any requirement that officers and directors or courts engage in public psychoanalysis about the real motives of corporate officers and directors for reaching a decision"); *Ward* v. *Succession of Freeman*, 854 F.2d 780, 791 (5th Cir. 1988) (securities "[c]ase law clearly holds that a defendant's motive is not a material fact"); *Golub* v. *PPD Corp.*, 576 F.2d 759, 765 (8th Cir. 1978) (federal law does not entitle shareholders to disclosure of the alleged "true motivation of * * * management in selling the assets of the company"); *Alabama Farm Bureau Mutual Casualty Co.* v. *American Fidelity Life Ins. Co.*, 606 F.2d 602, 610 (5th Cir. 1979) (there is no duty to disclose an "individual's motives or subjective beliefs").

The Third Circuit has summarized these precedents in the following terms, which are fully applicable to the case at bar: "The securities laws, while their central insistence is upon disclosure, were never intended to attempt any such measures of psychoanalysis or reported self-analysis." *Biesenbach*, 588 F.2d at 402. See also Ratner, *"Federal Corporation Law" Before and After Santa Fe Industries v. Green*, in *9th Annual Institute on Securities Regulation* 305, 322 (PLI 1978) ("It is not necessary to say, 'This is a grossly unfair transac-

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the other members of the board, including attorneys, businessmen, a housewife and an ex-Congressman, have all been held liable for large amounts of damages and branded as securities law violators based on naked speculation about their subjective state of mind.

tion in which the board of directors is overreaching the minority shareholders.' You just have to give them the facts"). The proxy statement in this case unquestionably set forth the objective material facts necessary to evaluate the directors' fairness opinion.

2. *The description of the financial adviser as "independent."* Much the same errors infect the Fourth Circuit's holding that the proxy statement misrepresented the status of KBW. To begin with, the court of appeals simply misconstrued the proxy statement in stating (Pet. App. 16a) that petitioners represented that KBW had made an "independent determination" of the fairness of the merger. Quite plainly, the proxy statement did *not* represent that KBW had made such an "independent determination" or that its $42 valuation was "the product of a completely independent analysis." *Ibid.* To the contrary, the proxy statement made crystal clear that KBW was retained *by FABI*, that it rendered its valuation *on the basis of information provided by FABI*, and that KBW *"did not attempt to verify independently any such information."* *Id.* at 54a, 75a (emphasis added). It is hard to imagine how the proxy statement could have been any more candid or explicit about the matter that the court below found to have been misrepresented.

What the proxy statement *did* say was that KBW is an "independent investment banking firm." Pet. App. 38a. But that characterization cannot form the basis for Section 14(a) liability both because it is an undeniably accurate description of KBW, as the word "independent" is commonly used, and because all of the facts that underlay the characterization of "independence" (or might have caused shareholders to question it) were fully and fairly disclosed in the proxy statement.

The first and foremost dictionary definition of the word "independent" precisely supports the usage in the proxy statement:

> "independent. 1. a. Not depending on the authority of another, not in a position of subordination or sub-

jection; not subject to external control or rule; self-governing, autonomous, free."

7 *Oxford English Dictionary* 848 (2d ed. 1989). See also *Webster's Third New International Dictionary* 1148 (1971), which defines "independent" as "1: not dependent: as a(1): not subject to control by others: not subordinate. * * * (2): not affiliated with or integrated into a larger controlling unit (as a business unit) * * * or made by individuals from outside a given unit." It is undisputed that KBW is an unaffiliated, outside, self-governing, and autonomous investment banking firm.

Respondents' contention that the proxy statement falsely characterized KBW as "independent" is based on another definition of the word "independent," one that focuses on KBW's freedom from the influence of others. We doubt that the word "independent" would have been misleading to the Bank's shareholders even if understood in that fashion. But the critical point is that respondents' preferred definition is not the *only* definition of the word; it is not even the primary or most natural definition. It is inconceivable that Congress intended to allow shareholders to impose massive damages liability under Section 14(a) on the ground that a proxy statement was false (indeed, fraudulent) by picking out one definition in the dictionary, when the language used was perfectly accurate under another commonly-accepted definition. Under that regime, drafters of proxy statements could never be certain that they would not be sued by imaginative shareholders armed with unabridged dictionaries.

In any event, even if that course were permissible, here again the proxy statement conspicuously and repeatedly disclosed the facts that respondents relied on to suggest a want of independence. It plainly set forth the contingent nature of the compensation agreement, which was standard in the industry (J.A. 143-144, 353): "For rendering its opinion to FABI, Keefe, Bruyette & Woods, Inc. will be paid $25,000, and if the Merger is consummated, will be paid an additional fee of $75,000" (Pet. App. 55a). The proxy statement also repeatedly stated—in four separate places—that KBW had been retained

and compensated by FABI, and not by the Bank. *Id.* at 38a, 54a, 55a, 74a (disclosing that "FABI's Board of Directors commissioned Keefe, Bruyette & Woods, Inc."). Beyond this, the proxy statement made clear that KBW obtained information relating to the issue of financial fairness directly from FABI, and twice recited that "Keefe, Bruyette & Woods, Inc. did not attempt to verify independently any such information." *Id.* at 54a, 75a. In disregarding these disclosures, the court below inexplicably failed to consider the "total mix" of information made available to investors. *TSC Industries*, 426 U.S. at 449.

Once the relevant facts of the relationship between FABI and KBW were fairly disclosed, shareholders had "no grounds under the 1934 Act for complaining about management's choice of words" in describing them. *Lessler* v. *Little*, 857 F.2d 866, 875-876 (1st Cir. 1988). See also *Golub*, 576 F.2d at 765 (plaintiffs had no right to have the proxy statement characterize the transaction "as plaintiffs would have it characterized"); *Kas*, 796 F.2d at 517 (a proxy statement "need not label or editorialize on the disclosed facts"); *Goldberg* v. *Meridor*, 567 F.2d 209, 218 n.8 (2d Cir. 1977) (Friendly, J.) (it is not deceptive for a proxy statement to fail to characterize disclosed facts with "pejorative nouns or adjectives"); *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255, 267 (3d Cir. 1972) ("[r]easonable latitude is important if nit-picking is not to become the name of the game"). In line with these principles, federal courts have recognized that it is not deceptive to use the adjective "independent" when shareholders are given sufficient facts to evaluate that characterization. See, *e.g.*, *Mills* v. *Esmark, Inc.*, 544 F. Supp. 1275, 1295 (N.D. Ill. 1982) (it is "well established that representations concerning the purported independence of a corporate committee are not generally actionable under the securities laws"); *Radol* v. *Thomas*, 534 F. Supp. at 1315 (rejecting a claim that it was improper to describe an investment banking firm as "independent"). The same result follows here.

This Court need not rely on its own reading of the proxy statement to determine whether the words "fair" or "independent" were capable of misleading a reasonable investor, given the substantial disclosures elsewhere in the proxy statement. Respondents produced *no* evidence at trial that the alleged misrepresentations actually misled any shareholder of the Bank. Indeed, perhaps the clearest possible demonstration that the proxy statement was not deceptive came from the mouths of the two named plaintiffs in this litigation, who testified that, immediately upon reading the proxy statement, they concluded that (at least in their view) the buyout price was not "fair" and that the investment banker was not "independent." In the words of respondent Sandberg (J.A. 118):

> "Q. And what did that [proxy] statement mean to you at that time?
>
> A. Well, it meant to me that they were approving this as being a high value.
>
> Q. Did you agree that it was a high value?
>
> A. No, I did not agree."

Similarly, respondent Weinstein testified in deposition that the proxy statement alerted him to the relationship between FABI and the investment banker and provoked his immediate objection to what he perceived to be a lack of independence (J.A. 58):

> "Q. Excuse me, was that apparent to you after reading the proxy statement?
>
> A. Sure. That Keefe, Bruyette was retained by the holding company. They were not independent.
>
> Q. Excuse me. What do you mean they weren't independent?
>
> A. They were operating at the direction of the holding company. The holding company retained Keefe, Bruyette and they were paying them.
>
> Q. Okay. So that was obvious from the proxy statement?
>
> A. Sure. It was also obvious from the proxy statement it was highly unusual to me that this appraisal of Keefe, Bruyette would be on a contingency basis * * *.

> Q. Did you check and see whether that was traditional in the investment banking world?
>
> A. No, I did not. The Keefe, Bruyette letter makes it quite clear that they did not verify a lot of the information that they received from the holding company."

Based on these perceptions, *garnered from the proxy statement itself*, respondents immediately filed protests with the Virginia Corporation Commission and also filed suit in state court complaining of the inadequacy of the merger price, conflict of interest, and the alleged lack of independence of the investment banker. See pp. 10-11, *supra*. In this context, it is sheer sophistry to say that the proxy statement was "misleading" to shareholders. Far from being misled by the proxy statement, respondents were galvanized into action by it and filed state court litigation alleging breach of fiduciary duty and inadequacy of the merger price.

II. A PLAINTIFF INVOKING AN IMPLIED CAUSE OF ACTION FOR DAMAGES UNDER SECTION 14(a) OF THE SECURITIES EXCHANGE ACT MUST DEMONSTRATE THAT THE ALLEGED PROXY VIOLATION CAUSED THE INJURY THE PLAINTIFF SEEKS TO REDRESS.

In addressing implied causes of action under Section 14(a), this Court repeatedly has stated that the plaintiff bears the burden of proving that the alleged wrong *caused* the damages sought to be recovered. As the Court explained in *Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322, 325 n.2 (1979): "A private plaintiff in an action under the proxy rules is not entitled to relief simply by demonstrating that the proxy solicitation was materially false and misleading. The plaintiff must also show that he was injured and prove damages." Stated otherwise, "damages should be recoverable only to the extent that they can be shown." *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 389 (1970).

The causation requirement has played a central role in this Court's decisions construing implied rights of ac-

tion under the federal securities laws. For example, in *Santa Fe*, 430 U.S. at 474 n.14, the Court rejected a claim of fraudulent non-disclosure in a corporate freeze-out merger, where the minority shareholders complained of failure to advise them in advance of the merger plan. The Court held that the alleged non-disclosure was not actionable because "under Delaware law [plaintiffs] could not have enjoined the merger" and because the plaintiffs "do not indicate how they might have acted differently had they had prior notice of the merger." Similarly, in *Blue Chip Stamps*, 421 U.S. at 746, the Court declined to grant standing to sue to a category of plaintiffs seeking damages pursuant to an implied cause of action, relying heavily on the speculative nature of their claim of causation: "The very real risk in permitting those in [plaintiffs'] position to sue under Rule 10b-5 is that the door will be open to recovery of substantial damages on the part of one who offers only his own testimony to prove * * * that the representations contained in [the disclosure document] damaged him." See also *Dirks*, 463 U.S. at 667 n.27 (declining to give weight to claims of "shareholder 'losses,' 'injury,' and 'damages'" where there was "no clear causal connection between inside trading and outsiders' losses"); *Basic Inc.* v. *Levinson*, 485 U.S. 224, 248 (1988) ("[a]ny showing that severs the link between the alleged misrepresentation and * * * the price received * * * by the plaintiff" is sufficient to break "the causal connection").

In this case, by contrast, the Fourth Circuit dispensed entirely with proof of causation. The court of appeals held that millions of dollars in damages may be recovered under Section 14(a) if the proxy statement "contained material misrepresentations and was an essential link in the merger" (Pet. App. 14a), even though the court acknowledged that the combined vote of the minority shareholders could not have affected the course of the merger transaction (*id.* at 13a-14a) and even though the minority shareholders, armed with allegations of breach of fiduciary duty and deception, attempted—but

failed—to block the merger or secure an appraisal remedy in state court (*id.* at 31a-33a).

This unprecedented holding nullifies Congress's declared policy that recovery in securities cases be limited to "actual damages on account of the act complained of" —*i.e.*, damages caused by the alleged infraction of federal proxy law. 15 U.S.C. § 78bb(a). "[A]ny extension of these laws, to approach something closer to an investor insurance scheme, should come from Congress, and not from the courts." *Basic*, 485 U.S. at 256-257 (White and O'Connor, JJ., concurring in part and dissenting in part).

A. Respondents Cannot Establish Causation Because The Outcome Of The Shareholder Vote Could Not Have Been Affected By Any Defect In The Proxy Statement.

In *Mills*, this Court left open the question whether causation in a Section 14(a) case "could be shown where the management controls a sufficient number of shares to approve the transaction without any votes from the minority." 396 U.S. at 385 n.7. We submit that this question admits of only one reasonable answer. The private cause of action for damages under Section 14(a) is designed to remedy injuries caused by distortion of the voting process; it should not be extended to encompass extraneous injuries that are unrelated to voting results.

As this Court has made clear, the purpose of Section 14(a) is "to prevent management or others *from obtaining authorization* for corporate action by means of deceptive or inadequate disclosure in proxy solicitation." *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 431 (1964) (emphasis added). Unlike the general antifraud provisions contained in the federal securities laws, such as Section 10(b) of the Securities Exchange Act, the scope of Section 14(a) is narrow and precisely drawn.[21] It is de-

[21] See *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 468 (1969) ("the existence or nonexistence of regulation under § 14 would not affect the scope of § 10(b) and Rule 10b-5. The two sections of the Act apply to different sets of situations").

signed to ensure that issuers of proxy statements do not abridge the right of shareholders to influence the outcome of corporate elections by casting their votes.[22]

Of course, it is often difficult to prove whether a defective proxy statement actually influenced enough votes to affect the outcome of the shareholders' vote. Hence, this Court in *Mills* announced a presumption to be employed in typical cases: if a shareholder can show that a proxy statement contained a misstatement or omission of material fact it will be presumed that the misstatement or omission affected the outcome of the vote. See *Mills*, 396 U.S. at 384-385. This approach is quite logical, inasmuch as the concept of materiality in such cases is itself defined by reference to what a reasonable shareholder would deem important in deciding how to vote. See *TSC Industries*, 426 U.S. at 449; *Mills*, 396 U.S. at 384.

When the Court declared these principles, however, it recognized that there is a common situation in which the logic of this presumption cannot be applied. When "management controls a sufficient number of shares to approve the transaction without any votes from the minority," *Mills*, 396 U.S. at 385 n.7, it is impossible to presume that even a material misrepresentation in a proxy statement could have caused damage to the voting interests of shareholders. To the contrary, in that situation it is

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[22] Writing for the Court in *Mills*, Justice Harlan explained (396 U.S. at 381):

> "As we stressed in *Borak*, § 14(a) stemmed from a congressional belief that '[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange.' H.R. Rep. No. 1383, 73d Cong., 2d Sess., 13. The provision was intended to promote 'the free exercise of the voting rights of stockholders' * * *. *Id.*, at 14; S. Rep. No. 792, 73d Cong., 2d Sess., 12; see 377 U.S., at 431."

Congress intended that proxy statements would fairly inform shareholders "as to the major questions of policy, which are decided at stockholders' meetings. Too often proxies are solicited without explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought." S. Rep. No. 792, 73d Cong., 2d Sess. 12 (1934).

certain that the outcome of the vote could *not* have been affected by anything contained in the proxy statement.

In ruling that the element of causation was satisfied notwithstanding the minority shareholders' inability to influence the result of the vote (Pet. App. 13a-14a), the court of appeals purported to follow *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 382-383 (2d Cir. 1974). In *Schlick* the Second Circuit suggested that even when the proxy statement could have had no impact on the outcome of the vote, the minority shareholders should be allowed to demonstrate that the misrepresentations in the proxy statement caused them injury in some other way. For example, it may be possible for them to show that an accurate proxy statement would have provided information necessary to enjoin the transaction in state court (so-called "sue facts"). Or the plaintiffs may be able to prove somehow that the true facts were so embarrassing that management would have chosen to forego the transaction rather than "hang its dirty linen out on the line" by issuing an accurate proxy statement (so-called "shame facts"). *Schlick*, 507 F.2d at 384; see Gelb, *Rule 10b-5 and Santa Fe—Herein of Sue Facts, Shame Facts, and Other Matters*, 87 W. Va. L. Rev. 189 (1985).

The *Schlick* approach to causation is inconsistent with the purposes of Section 14(a) and serves to allow plaintiffs to recover damages that are absolutely unrelated to the purported violation of federal proxy law. As noted above, the avowed purpose of Section 14(a) is to protect the voting process—not to create an adjunct discovery system to facilitate lawsuits in state court. If a shareholder's interest in influencing the corporate election has not been impaired, he has not suffered a Section 14(a) injury and is not entitled to collect damages under that provision.

In *Piper* v. *Chris-Craft Industries*, 430 U.S. at 26-41, this Court stressed the need to identify the precise interests Congress sought to protect in order to determine how broadly courts should extend an implied

cause of action for damages under the securities laws. Because the focus of the Williams Act was the protection of investors confronted with tender offers, and not the protection of unsuccessful tender offerors who might be injured by Section 14(e) violations, the Court held in *Piper* that recognizing a private damages action for tender offerors was not "necessary to effectuate Congress' goals." *Id.* at 26. So, too, with respect to Section 14(a): Congress's interest was protecting shareholders' votes, and damages actions for injuries unrelated to those votes are unrelated to the goals of Section 14(a). Certainly, it cannot be said that extending Section 14(a) to non-voting injuries is "necessary to effectuate Congress' goals." *Piper*, 430 U.S. at 26; *Santa Fe*, 430 U.S. at 477-480; *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 578 (1979).[23]

When the Second Circuit adopted its contrary position in *Schlick* in 1974, this Court had not yet begun to stress the federalism and separation of powers concerns implicated by expansive judicial creation of implied causes of action for damages under the federal securities laws.[24] In *Santa Fe*, for example, this Court roundly

[23] To paraphrase from the approach this Court has taken in addressing antitrust injuries:

> "Plaintiffs must prove [proxy law] injury, which is to say injury of the type the [proxy] laws were intended to prevent and that flows from that which makes defendants' acts unlawful."

Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977); see *Sundstrand Corp.* v. *Sun Chemical Corp.*, 553 F.2d 1033, 1050 (7th Cir. 1977) (requiring "securities law" injury).

[24] A number of Justices have recently questioned the correctness, as an original matter, of *J.I. Case Co.* v. *Borak*, *supra*, in which the Court recognized a private cause of action for damages under Section 14(a). See Pet. 22-23 n.6 (quoting opinions). Whether or not the Court is inclined to overrule *Borak*, concern that it was wrongly decided counsels strongly against extending it even further than it has already been extended. See *Shearson/American Express* v. *McMahon*, 482 U.S. 220, 234 (1987) ("While *stare decisis* concerns may counsel against upsetting [*Wilko* v. *Swan*'s, 346 U.S. 427 (1953)] contrary conclusion * * * we refuse to extend *Wilko*'s reasoning").

rejected the Second Circuit's holding that a minority shareholder could recover under the securities laws if the majority "committed a breach of its fiduciary duty to deal fairly with minority shareholders." See 533 F.2d at 1291. The Court explained that while there "may well be a need for uniform federal fiduciary standards to govern mergers," those standards "should not be supplied by judicial extension of [the securities laws] to 'cover the corporate universe.'" 430 U.S. at 477-480.

That message extends to the *Schlick* decision as well. As one leading commentator recently observed: "It is highly questionable whether [*Schlick* and its progeny] are consistent with the Supreme Court's concern of freeing the federal courts from claims that are based on state law and breaches of fiduciary duties." T. Hazen, *Securities Law* 670 (2d ed. 1990). See also R. Jennings & H. Marsh, *Securities Regulation* 1091 (6th ed. 1987) ("these cases hold that the existence of a remedy under state law *creates* a cause of action under [the federal securities laws]. This would seem to be standing *Santa Fe Industries* on its head"). Whether a differently worded proxy statement may have been helpful to the maintenance of a state court action (by providing so-called "sue facts") is simply irrelevant to determining whether a respondent's *vote* has been unfairly solicited.[25]

For these reasons, the "sue facts" theory of causation has no basis in the language or purpose of Section 14

[25] Even under Section 10(b), it is highly doubtful whether federal jurisdiction should be conferred based on speculations about the prospects of hypothetical litigation in state court. See Jorden & Greif, *Federal Securities Fraud and State Law Fiduciary Duties—A Tour of the Circuits Reveals Continuing Confusion*, 19 Idaho L. Rev. 211, 238 (1983) ("[t]hese disclosure and antifraud statutes were not designed to enable stockholders to evaluate the feasibility of state court injunction suits in federal forums, but rather to facilitate informed investment (or voting) decisions"). But even if this focus on state court litigation had merit under general antifraud provisions such as Section 10(b), it has no place under Section 14(a), a precisely-drafted statute dealing only with corporate voting. See pp. 39-40, *supra*.

(a). But it is even less justifiable to allow minority shareholders to recover damages under Section 14(a) on the theory that a more informative proxy statement might have helped them to place pressure on the controlling shareholder to abandon the merger. Not only is such a "shame facts" theory wholly unrelated to the purpose of Section 14(a), but it also allows damages to be predicated on the most speculative and conjectural assumptions about how a diverse group of directors might react to potentially adverse publicity. Allowing respondents to recover millions of dollars on such a flimsy basis is surely inconsistent with the requirement that those invoking private causes of action satisfy the "traditional principles" of tort actions—including the element of causation. See *Rondeau* v. *Mosinee Paper Corp.*, 422 U.S. 49, 62-63 (1975).[26]

A holding in this case that respondents failed to prove causation of voting injury would not, of course, imply that the *government* lacks effective remedies against misleading proxy statements. A wide array of administrative, injunctive and even criminal sanctions are potentially available upon a showing of a culpable violation of Section 14(a), without regard to whether the proxy statement actually *caused* injury to the voting process. See, *e.g.*, 15 U.S.C. § 78u(d); 15 U.S.C. § 78*o*(b)(4); 15 U.S.C. § 78ff(a). Plaintiffs invoking a private cause of action for *damages* are, however, in a very different position. As this Court has stated: "*Mills* could not be plainer in holding that the questions of liability and relief are separate in private actions under the securities

[26] See also *Bastian* v. *Petren Resources Corp.*, 892 F.2d 680, 685 (7th Cir. 1990) (Posner, J.) (the securities laws embody "the standard rule of tort law that the plaintiff must allege and prove that, but for the defendant's wrongdoing, the plaintiff would not have incurred the harm of which he complains"); *Prosser and Keeton on Torts* § 41, at 269 (5th ed. 1984) ("A mere possibility of such causation is not enough; and when the matter remains one of pure speculation or conjecture, or the probabilities are at best evenly balanced, it becomes the duty of the court to direct a verdict for the defendant").

laws, and that the latter is to be determined according to traditional principles." *Rondeau*, 422 U.S. at 64. See also *Blue Chip Stamps*, 421 U.S. at 751 n.14 (limitations on implied damages actions do not inhibit "the SEC [in] bring[ing] actions for injunctive relief"); *Piper*, 430 U.S. at 40 n.26 ("injunctive relief at an earlier stage of the contest is apt to be the most efficacious form of remedy").

B. Even If Non-Voting Injuries Are Deemed Cognizable Under Section 14(a), Respondents Have Not Proved That The Proxy Statement Caused Them Any Harm.

Even if Section 14(a) were construed to authorize private damages actions alleging non-voting injuries, respondents still would be required to sustain the burden of *proving* causation. In this case, the district court and court of appeals dispensed with that requirement entirely and allowed respondents to recover millions of dollars in damages without any showing of how the proxy statement affected their financial situation. This approach went far beyond the reasoning of *Schlick* or any subsequent decision. Those decisions have struggled with the question of how a respondent can prove causation, but none of them has abandoned this basic requirement altogether.[27]

Respondents contended in the courts below that Section 14(a) damages liability would be established if they could prove a material misstatement in a proxy statement that was a necessary prerequisite to the merger. Pet. App. 14a. In an ordinary Section 14(a) case, in which a proxy statement relates to a shareholder vote that can be decided either way, the showing of a material misstatement may serve as a surrogate for proof of causation. Once a plaintiff has shown "a substantial likelihood that a reasonable shareholder would consider [the

[27] Although *Schlick* spoke of the opportunity to establish that an accurate proxy statement would have allowed the plaintiff to obtain relief in state court, it cautioned that "[c]ausality, we think, is sufficiently pleaded; the *proof may, of course, be something else.*" 507 F.2d at 383 (emphasis added).

omitted fact] important in deciding how to vote," *TSC Industries*, 426 U.S. at 449, it is reasonable to apply a rebuttable presumption that any violation of the proxy laws affected the outcome of the vote. See *Mills*, 396 U.S. at 384-385. But as discussed above (see pp. 40-41, *supra*), a showing that shareholders would have considered information important in deciding how to *vote* "hardly embodies a conclusion that the non-controlling minority might have somehow, apart from their voting power, prevented the merger from taking place on the terms proposed." *Swanson* v. *American Consumers Industries*, 475 F.2d 516, 518 n.2 (7th Cir. 1973). It is obvious that if non-voting causation is to be recognized at all, the inquiry cannot focus, as it does in voting cases, on what a reasonable investor would consider important in deciding how to vote. Instead, the plaintiff must prove that if the proxy statement had not contained the challenged misrepresentation, then the minority shareholders would have been able to enjoin the merger. See *Santa Fe*, 430 U.S. at 474 n.14.

Thus, even if non-voting injuries were actionable under Section 14(a), minority shareholders still would be required to prove "that they would have succeeded" in preventing the merger "if they had been advised of the truth and had pursued [their available] remedies." *Madison Consultants* v. *FDIC*, 710 F.2d 57, 64 (2d Cir. 1983). Although the circuits have disagreed about the applicable standard of proof, they are united in requiring distinct and non-speculative proof of causation in this context. The Second and Ninth Circuits have held that a plaintiff must show that he would have actually "succeeded in preventing the loss he in fact suffered." *Madison Consultants*, 710 F.2d at 65; accord, *Kidwell ex rel. Penfold* v. *Meikle*, 597 F.2d 1273, 1294 (9th Cir. 1979). The Third Circuit similarly requires the plaintiff to show that he would have had a reasonable probability of success in a state-court injunctive proceeding. See *Healey* v. *Catalyst Recovery of Pennsylvania, Inc.*, 616 F.2d 641, 647 (3d Cir. 1980). The Fifth

Circuit has taken the most permissive approach, but it still requires the plaintiff to demonstrate that he could have made out a prima facie case for state-court injunctive relief. See *Alabama Farm Bureau Mutual Casualty Co.* v. *American Fidelity Life Ins. Co.*, 606 F.2d 602, 614 (5th Cir. 1979).[28]

In our view, the standard adopted by the Second and Ninth Circuits is most consistent with this Court's prior decisions requiring non-speculative proof of causation. See pp. 37-38, *supra*. Unless a plaintiff can prove that a more informative proxy statement would have allowed him to prevent the merger, it cannot possibly be said that the misrepresentation "caused" his injury.[29] But resolution of this difference among the circuits is not critical to the outcome of this case. For no matter how the standard of proof is defined, it is manifest that respondents did not and could not satisfy the requirement of establishing causation in a non-speculative manner.

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[28] Although these cases have arisen under Rule 10b-5, the causation requirement extends to Section 14(a) as well. See L. Loss, *Fundamentals of Securities Regulation* 809 (2d ed. 1988) (discussing cases); R. Jennings & H. Marsh, *Securities Regulation* 1287 (6th ed. 1987) (the standard of causation under Section 14(a) is at least as strict as the standard under Rule 10b-5).

[29] Judge Mansfield's analysis for the Second Circuit in *Madison Consultants* (710 F.2d at 65) is compelling:

> "In our view the 'cause of action' test and the 'prima facie case' test are too weak to satisfy Rule 10b-5's requirement that the plaintiff's injury be caused in fact by the defendant's conduct. * * * A test that looks only to the statement of a claim for relief would mandate a finding of causation even in cases in which the plaintiff would almost certainly have lost at a later stage in the case, such as on a summary judgment motion based on undisputed facts. A test that looks to the existence of a prima facie case, besides employing a notoriously ambiguous piece of legal terminology * * * would require a finding of causation even when the defendant could devastatingly rebut the plaintiff's case. The adoption of such standards would come too close to the creation of a presumption of causation."

To begin with, throughout this litigation, respondents insisted on trying their case without offering any proof of causation. See Opp. 22 ("Respondents established the causal connection between the merger and their loss by proving that the stock the merger converted into $42 was worth $60. That is exactly what *Mills* requires"). Thus, respondents never even attempted to show that the merger could have been prevented on a "sue facts" or a "shame facts" theory if the proxy statement had made what they deemed to be accurate disclosures. Similarly, consistent with respondents' litigation strategy, and despite repeated objections, the district court never asked the jury to consider the issue of causation under proper instructions.[30] Instead, the court merely instructed the jury that if it found that there was a material misrepresentation and that the proxy statement was an "essential link" in the transaction (J.A. 426), then it could find in favor of respondents. Indeed, the court told the jury that "you are instructed it is no defense that the votes of the minority stockholders were not needed to approve the transaction." J.A. 427.

But beyond that, in view of the prior rulings of the Virginia courts and regulators, it is apparent that respondents could not have met their burden of proving causation in this non-voting context. Immediately after the proxy statement was issued, a group of minority shareholders (all of whom are parties to this litigation) sought to stop the shareholder meeting and the merger in two separate Virginia proceedings. In a lengthy submission to the Virginia Corporation Commission, respondent Weinstein and a group of other shareholders asked the Commission to stop the merger because the Bank's directors allegedly acted in violation of their

[30] Petitioners repeatedly urged the district court to hold that this was not an ordinary voting case and that the *Mills* standard should not be applied. See J.A. 76-77 (brief in support of summary judgment, arguing that the *Schlick* "rule makes no sense, and it particularly makes no sense in this case"); J.A. 426, 435 (objection to instruction on "essential link").

fiduciary duty, acted without a valid corporate purpose, failed to conduct an independent investigation or secure an independent appraisal, and offered shareholders a grossly inadequate price. J.A. 29-36. Notwithstanding these allegations, the Corporation Commission refused to block the merger. J.A. 37-39.

The shareholders had no more success in state court, despite repeated efforts to obtain an injunction or appraisal. Armed with detailed allegations based on information derived from the proxy statement, they contended in state court that the merger plan afforded them inadequate consideration, that the directors breached their fiduciary duty by failing to retain an independent financial adviser, that the directors acted in violation of their duties of care and loyalty and suffered from a conflict of interest, and that the directors purportedly committed deception through numerous non-disclosures and misrepresentations. J.A. 6-18. The Virginia Circuit Court nonetheless denied all relief and the Virginia Supreme Court declined review. Pet. App. 31a-33a; J.A. 19-28. As in *Santa Fe*, it is clear beyond dispute that respondents "could not have enjoined the merger." 430 U.S. at 474 n.14.

By the same token, respondents could not possibly have proven that a differently worded proxy statement would have "shamed" petitioners into abandoning the merger. This merger was authorized by state statute regardless of minority shareholder dissent. The merger served important corporate purposes; it had the approval of state and federal bank regulators; state courts had refused to enjoin it or afford an appraisal; and the vast majority of minority shareholders were delighted with the 30% premium they received. See pp. 2-10, *supra*. It is ludicrous to suggest that a redrafting of the proxy statement would have "shamed' the majority shareholder or the Bank's directors into abandoning this beneficial transaction.[31]

[31] The impermissibly speculative nature of the "shame facts" theory of causation is apparent upon considering the damages

The lower courts never addressed any of these causation issues because they misread *Schlick* as totally dispensing with the element of causation. The effect of that error was to expose petitioners to millions of dollars in liability, even though respondents never attempted to prove—and could not have proved—that the supposedly misleading proxy statement caused them any financial injury, much less the enormous damages awarded in this case.

CONCLUSION

The decision of the court of appeals should be reversed with directions to enter judgment in petitioners' favor on the federal securities law claims.

Respectfully submitted.

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awarded in this case. A jury would have to extrapolate from a hypothetical level of "shame" to an ability to extract $60 per share from the majority shareholder—an award of damages that was twice as much as the shares traded for during the years preceding the merger. See Pet. App. 64a. If respondents had somehow succeeded in halting or even delaying the merger, all minority shareholders would have been left with shares with a market value of $32 per share—or, more likely, a lesser amount, since the prospect of a buyout in the future would have been greatly reduced. Such a development would not have been welcomed by the great majority of minority shareholders who desired to sell their shares *promptly* at a *30% premium*. See pp. 8, 10, *supra*.

STATUTORY APPENDIX

STATUTORY APPENDIX

1. Section 14(a) of the Securities Exchange Act, 15 U.S.C. § 78n(a), provides:

> "It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title."

2. Section 12(i) of the Securities Exchange Act, 15 U.S.C. § 78*l*(i), provides in pertinent part:

> "In respect of any securities issued by banks the deposits of which are insured in accordance with the Federal Deposit Insurance Act [12 U.S.C. § 1811 *et seq.*] * * * the powers, functions, and duties vested in the Commission to administer and enforce this section and sections 78m, 78n(a), 78n(c), 78n(d), 78n(f), and 78p of this title * * * are vested in the Federal Deposit Insurance Corporation * * *."

3. Section 28(a) of the Securities Exchange Act, 15 U.S.C. § 78bb(a), provides in pertinent part:

> "[N]o person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of."

4. 12 C.F.R. § 335.206(a), promulgated by the Federal Deposit Insurance Corporation, provides in pertinent part:

> "No solicitation or communication subject to this Subpart B shall be made by means of any state-

ment, form of proxy, notice of meeting, or other communication, written or oral, containing any statement that, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or that omits to state any material fact necessary in order to make the statement therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter that has become false or misleading. Depending upon particular circumstances, the following may be misleading within the meaning of this section: * * * material that directly or indirectly impugns character, integrity, or personal reputation, or directly or indirectly makes charges concerning improper, illegal, or immoral conduct or associations, without factual foundation; * * *."

5. Section 13.1-718E of the Code of Virginia provides in pertinent part:

> "Unless this chapter or the board of directors, acting pursuant to subsection C of this section, requires a greater vote, the plan of merger or share exchange to be authorized shall be approved by each voting group entitled to vote on the plan by more than two-thirds of all the votes entitled to be cast by that voting group."

6. Section 13.1-614B of the Code of Virginia provides in pertinent part:

> "No court within or without this Commonwealth shall have jurisdiction to enjoin or delay the holding of any meeting of directors or shareholders for the purpose of authorizing or consummating any amendment, merger, exchange or dissolution or the execution or filing with the Commission of any articles or other documents for such purpose, except pursuant to subsection C of § 13.1-661 or for fraud."

7. Section 6.1-43 of the Code of Virginia provides in pertinent part:

> "Banks may merge upon compliance with the provisions of Article 12 * * * of the Virginia Stock Corporation Act. However, * * * the provisions of § 13.1-730 [dissenters' right to appraisal remedy] shall not apply to a merger under this section."

8. Section 13.1-692.1A of the Code of Virginia provides in pertinent part:

> "In any proceeding brought by or in the right of a corporation or brought by or on behalf of shareholders of the corporation, the damages assessed against an officer or director arising out of a single transaction, occurrence or course of conduct shall not exceed the lesser of:
>
> 1. The monetary amount, including the elimination of liability, specified in the articles of incorporation, or, if approved by the shareholders, in the bylaws as a limitation on or elimination of the liability of the officer or director; or
>
> 2. The greater of (i) $100,000 or (ii) the amount of cash compensation received by the officer or director from the corporation during the twelve months immediately preceding the act or omission for which liability was imposed."